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FINANCIAL DIGEST

FRIDAY, FEBRUARY 15, 1980 VOLUME XVII , NUMBER 7

INFLATIONARY EXPECTATIONS HEAT UP

The recent volatility exhibited by all sectors of the fixed-income securities market is another disturbing indication that the Administration's efforts to curb inflation have not yet dampened inflationary expectations. In fact, quite the opposite has occurred—traders and investors have seemingly decided that the fight against inflation will be unsuccessful in both the short- and the long-run as well. According to this view, stepped-up defense outlays, widening budget deficits and a more accommodative Federal Reserve stance will add up to a more-robust-than expected economy, producing continued high inflation and necessitating further interest rate increases. Thus, the attractiveness of long-term bonds has plummeted in recent weeks (along with their prices), and yields have moved sharply higher.

Long-term government bond prices have been under heavy downward pressures recently, and yields have risen accordingly. Although interest rates reached new peaks, the Treasury undertook a three-stage refunding operation during the first week in February. New 3½-, 7¼-, and 30-year issues were sold at average yields of 11.98, 12.02 and 11.84 percent, respectively—all record high levels. Consequently, with long rates soaring and short rates comparatively stable (as investors chose to "park" their funds in short maturities), the steeply inverted government yield curve flattened considerably. The long-to-short differential between thirty-year bonds and three-month bills narrowed to 63 basis points in favor of short rates during the first week of February, compared with a negative spread of 146 basis points only one week earlier and one of more than 275 basis points in late October 1979.

The price rout that unfolded in the long-term government sector occurred in the corporate sector, too, producing record high yields. Against this backdrop of unsettled market conditions and rapidly rising yields, a recent, triple-A rated Bell Telephone issue met moderate investor resistance despite being priced to yield 12.70 percent. As in the government sector, relatively stable short-term rates combined with substantially higher long-term rates to produce a marked flattening of what had been an inverted corporate yield curve. In fact, the long-to-short differential between new issue triple-A utility yields and three-month commercial paper disappeared entirely at the end of the first week in February, compared with a negative 65 basis point spread one week earlier and a spread of almost 300 basis points in late October 1979.

Finally, the positive long-to-short yield spread between new issue municipal bond rates and prime municipal notes has also widened substantially in recent months. As in the federal and corporate sectors of the credit markets, high inflation and a large volume of new credit demands have eroded the attractiveness of fixed-income securities, sending prices plummeting and yields upward. Thus, the long-to-short differential widened to 135 basis points in early February, compared with an 85 basis point differential at year-end 1979 and a negative 30 basis point differential in late October-early November 1979.

CONSUMER SPENDING LOOKS STRONG . . .

If the potential impact on inflation of fiscal and monetary policy is disturbing to the financial markets, the course being taken by the "real" economy does not make them sanguine, either. Conclusive evidence that the U.S. was lapsing into its seventh postwar recession might make financial market participants less uneasy over the course of economic policy, since recessions tend to moderate inflation and the expectation of inflation. Unfortunately, such evidence has yet to arrive on the scene.

For example, in the important consumer sector, where

(continued)

SELECTED FEDERAL RESERVE DATA

(Weekly Averages of Daily Figures—Millions of Dollars)

	Week Ending 2/6/80	Change Since Week Ago	Change Since Year Ago
Reserve Bank Credit:			
U.S. Gov'ts and Agencies Owned Outright & RPs	123,786	— 999	+10,660
Member Bank Borrowings	759	—1,062	— 58
Float	5,074	+1,487	— 901
Total Reserve Bank Credit	134,984	— 762	+ 9,316
Treasury Deposits with Federal Reserve Banks	2,976	— 63	— 691
Currency Outside Banks	109,247	— 342	+ 9,367
Member Bank Reserves:			
Required	43,358	—1,028	+ 2,120
Excess (Deficiency)	556	+ 277	+ 277
Total Reserves Held	43,914	— 751	+ 2,397
Net Borrowed Reserves	130	— 771	+ 248
Money Supply ($ Bil., SA) M1-A	376.8	+ 3.7	NA
Money Supply ($ Bil., SA) M1-B	393.0	+ 3.1	NA

		Change Since Month Ago	Change Since Year Ago
M2 ($ Bil., SA) (Dec. '79)	1,523.9	+ 9.4	8.8%
L ($ Bil., SA) (Nov. '79)	2,124.8	+ 9.4	11.3%

NEW YORK MONEY MARKET

Offering Rates 2/15/80	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	12.90%	12.80%	12.40%
*Federal Agencies	13.00	13.00	12.95
*Project Notes—Tax Free (46% Taxable Equivalent)	10.18	11.57	11.29
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	14.15	14.40	

‡Finance Company Paper—Prime

5- 14 days	8.00%
15- 29 days	12.00
30- 89 days	13.10
90-239 days	12.00
240-270 days	10.00

‡Industrial Paper—Prime

30- 59 days	13.25%
60- 89 days	13.10
90-120 days	13.05

‡*Bankers' Acceptances

Mar.	13.50%
Apr.	13.65
May	13.75
June	13.75
July	13.60
Aug.	13.45

†Federal Funds Effective Rate 14.60%

‡Discount Basis. *Subject to Availability. †Estimated.

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'79	$ 2,456	$ 2,397	$ 2,235
Gross National Product (1972 Dollars)*	4th Q'79	$ 1,438	$ 1,433	$ 1,427
Percent Change, Annual Rate	4th Q'79	1.4%	3.1%	5.6%
Change in Consumer Prices (all urban consumers)*	Dec. '79	14.4%	12.0%	8.0%
Change in Producer Prices*	Jan. '80n	19.2%	10.8%	14.4%
Civilian Employment (Thousands of Persons)†	Jan. '79	97,804	97,912	96,157
Unemployment as % of Civilian Labor Force†	Jan. '79	6.2%	5.9%	5.8%
Personal Income*	Dec. '79	$ 2,023	$ 2,000	$ 1,827
Leading Indicators Composite Index (1967=100)†	Dec. '79	136.8	136.8	143.0
Industrial Production Index (1967=100)†	Jan. '80n	152.7	152.3	151.5
Net Change in Consumer Instalment Credit†	Dec. '79	$ 1.55	$ 2.41	$ 4.40
U.S. Merchandise Trade Balance†	Dec. '79	—$ 3.08	—$ 1.42	—$ 1.75
Plant and Equipment Expenditures*	1st Q'80	$189.32(a)	$179.56	$165.94
Private Housing Starts (Thousands of Units)*	Dec. '79	1,527	1,522	2,074
New Construction Expenditures*	Dec. '79	$ 239.6	$ 237.4	$ 223.2
Total Business Inventories†	Dec. '79n	$ 426.3	$ 424.4	$ 379.6
Total Business Sales†	Dec. '79n	$ 301.3	$ 299.3	$ 272.5

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

SHORT TERM PAPER OUTSTANDING

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CDs Weekly Reporting Banks			
Nationwide (1/30/80)	92,615	+ 765	— 3,628
New York City (1/30/80)	20,298	+ 434	— 8,841
Commercial Paper (1/30/80)	117,669	+ 172	

BANK LOANS

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Commercial and Industrial Loans Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/30/80)	156,605	+ 134	+24,217
New York City (1/30/80)	46,973	+ 87	+ 8,814

	Total Loans Gross Adjusted Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/30/80)	396,265	+3,155	+54,706
New York City (1/30/80)	88,474	+ 985	+12,358

SECURITY MARKETS

	Friday 2/15/80	Change Since Week Ago	Change Since Year Ago
U. S. Governments, Closing Bid Prices:			
90-Day Bills (Discount Basis)	12.82%	+ .72	+ 3.54
180-Day Bills (Discount Basis)	12.89	+ .78	+ 3.54
Longest Bills (Discount Basis)	12.37	+ .75	+ 3.03
11½s 1/31/82	97.5	—1-16/32	
11⅞s 8/15/83	98.23	—1-17/32	
10¾s 11/15/89	92.00	—2-12/32	
10½s 2/15/95	88.10	—2-18/32	
11¾s 1/15/10	97.4	—3-14/32	
Municipals:			
Bond Buyer—20 Bond Index* (2/14/80)	7.75%	+ .04	+ 1.42
Blue List Total ($ Million)	$ 735	—$ 36	—$ 78
30-Day Visible Supply ($ Million)	$2,376	+$1,167	+$1,174
Total	$3,111	+$1,267	+$1,232
Corporates:			
Moody's Aa Composite (2/14/80)	12.58%	+ .30	+ 3.09
Money Mgr.—30-Day Supply ($ Million)	$1,248	—$ 184	+$ 368
Stocks:			
Dow-Jones Averages			
Industrials	884.98	— 10.67	+ 57.97
Transportation	287.20	— 18.60	+ 75.43
Utilities	111.20	— 0.13	+ 6.84
65 Stocks	321.20	— 8.39	— 40.02
Standard and Poor's 500 Stocks	115.41	— 2.54	+ 16.74
N.Y.S.E. Composite Index	66.14	— 1.43	+ 10.77
N.Y.S.E. Avg. Daily Vol. for Week (000's)	53,954	+ 3,410	+29,950

*46% Taxable Equivalent 14.35%

INTERNATIONAL RATES

	Friday 2/15/80	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	14.00%	13.13%
1 month	14.25	13.88
3 months	14.94	14.38
6 months	15.00	14.38
1 year	14.63	14.63
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	NA	12.67%
Long Term (10 to 15 yrs.)	NA	11.75
FOREIGN EXCHANGE SPOT RATES New York Opening (in dollars)		
Belgium	.03539	.03544
Canada	.8623	.8627
France	.2451	.2450
Germany	.5754	.5752
Italy	.001242	.001239
Japan	.004105	.004139
Mexico	.04382	.04378
Netherlands	.5222	.5214
Switzerland	.6169	.6159
U.K.	2.3060	2.2975

two out of every three gross national product dollars are spent, strength still apparently remains. According to the Commerce Department, retail sales in January rose by a hefty 2.3 percent compared with December, seasonally adjusted. This was considerably larger than December's 0.5 percent increase, as well as the average monthly increase of 0.7 percent reported for the entire year 1979.

. . . BUT IS IT ?

Because sales and employment track pretty closely and because employment had fallen in January, a rise in retail sales this substantial is surprising. However, a closer look at the numbers offers some explanations for the big increase. For one thing, January was unseasonably mild throughout most of the country. Since the past several Januaries have produced severe winter weather—either in the form of blizzards and/or extreme cold—the seasonal adjustment factors for the month have been pulled down, in order to compensate for these weather developments. Thus it stands to reason that sales would look better than they really are under normal weather conditions—much less a mild January such as the one we just had.

Another explanation might lie in the sales trend of December. Because the gain in sales in the month was below 1979's average (not to mention only half the increase reported in November), it is possible that many consumers waited for January before making their purchases, with the hope that they might get a break on prices after the Christmas selling season. Again, such counter-seasonal trends would tend to make January's sales look better than they really were.

Whatever the case, it does not appear that consumers have the ability to keep spending the way they have been doing. People's use of credit correlates pretty closely with their ability to find jobs. The recent decline in employment suggests less use of debt in the near future. Indeed, the December figures on consumer credit indicate that this might already be underway. December's increase of $1.55 billion in consumer installment credit outstanding was the smallest monthly rise in nearly four years. As recently as September, 1979, the monthly increase totaled $4½ billion. Relative to take-home pay, the net change in consumer credit in December equalled little more than one percent compared with over 3½ percent at the peak reached early in 1978. The last time people cut down on their use of credit this fast was just prior to, and during, the 1973-75 recession. Not surprisingly, fewer goods are being bought on time. About one-third of December's retail sales was bought with credit, compared with over 39 percent in the spring of 1979.

SAVINGS RATE STILL LOW

The strength in spending in the face of reduced use of credit (and the continued erosion of buying power from current incomes by the high rate of inflation) suggests that the savings rate is still falling. At year-end, people were putting aside little more than three percent of their take-home pay, about half the average of the 1970s, and one of the lowest such percentages in the past 30 years. In some cases, people are saving less in order to continue buying essentials. Studies by this Bank conclude that sales of essentials are not significantly affected by price changes in the short run. Since some of the biggest increases in prices have come in essentials (energy, shelter, and food), many people have had to lay out more dollars in order to keep purchasing the same volume of essentials in real terms. Plainly, if they don't cut back proportionately on sales of discretionary items, they have less money to save.

Some consumers, on the other hand, view the purchase of certain items as a means of saving, although this does not show up as such in the national statistics. Reference is made to the purchase of collectibles (art, jewelry, antiques) as a means of saving. In the national statistics, these purchases would be counted as consumption, thus a subtraction from income, although to many people who buy these goods, they constitute a form of saving. The bottom line, however, is that this type of saving is no more available for potential future consumption than the purchase of a house, car, or any other consumable good. This is because such collectibles tend to be relatively illiquid—that is, they cannot be sold quickly when funds may be needed.

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1 Gerry Raffles Square, London E15 IXB

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Manufacturers Hanover Bank International (Los Angeles)
445 South Figueroa Street
Los Angeles, California 90071

MHT-Servicos e Administracao Ltda.
Edificio Eloy Chavez, Avenida Paulista
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Manufacturers Hanover Bank International (Miami)
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Columbus House, Shirley Street

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Headquarters office: 350 Park Avenue
New York, N.Y. 10022
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